Appendix A—Opinions and Orders

Opinion of United States District Court for the Southern District of New York

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
65-Civ. 3416

[SAME TITLE]

CROAKE, District Judge

MEMORANDUM

These are motions: (a) by the plaintiff, pursuant to Rule 65, Fed. R. Civ. P., to stay arbitration, and (b) by the defendant, pursuant to Rule 7(b), Fed. R. Civ. P., and 9 U. S. C. A. §1 et seq., to stay this action pending arbitration. Both motions will be decided in the instant opinion.

This action arises out of a Consulting Agreement entered into on October 7, 1964 whereby the defendant agreed to serve the plaintiff "in an advisory and consultative capacity," not to compete with Prima, and to turn over to the plaintiff certain customer lists. Prima agreed to make payments to Flood & Conklin, commencing September 1, 1965, based upon sales to former customers of the defendant.

Paragraph 8 of the Consulting Agreement states:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the

City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima and F&C."

On or about October 14, 1964, the defendant filed a voluntary petition under Chapter XI of the Bankruptcy Act. An Amended Plan of Arrangement was confirmed and the debtor was revested with its assets on March 16. 1965.

In a letter to the attorneys for the defendant dated September 17, 1965, the plaintiff alleged certain "breaches" of the agreement by F&C. On October 25, 1965 the defendant served a Notice of Intention to Arbitrate on the plaintiff; and, on November 12, 1965, three days before the expiration of the plaintiff's time to appear, answer or otherwise move with regard to the demand for arbitration, Prima instituted this action seeking to rescind the Consulting Agreement on the grounds of fraud in the inducement.

In an affidavit dated November 20, 1965, one Albert A. Shuger, the President of the plaintiff, alleges that "the parties hereto had originally agreed to execute the agreement on October 21, 1964. However, upon the urging and pleas of Jerome K. Jellin, principal of the defendant corporation, because of the need of the proceeds of the sale for another business investment, the date was accelerated and the agreement executed earlier and on October 7,

1964. . . . If the true facts had been known to the plaintiff, i. e., the defendant intended to file bankruptcy proceeding and immediately avail itself of the insolvency act, no agreement would have been entered into between the parties because such action would have and did damage, frustrate, impede and breach the agreement of the parties and was contrary to the very intention of the parties to the agreement. . . ." No fraud is specifically alleged with regard to the arbitration provision.

The court has read the extensive memoranda of law submitted and, after careful consideration, is of the opinion that this action should be stayed pending arbitration. The plaintiff urges several lines of argument but they are of no avail. The arbitration clause herein is broad and is almost identical to the one recommended by the American Arbitration Association. See *In Re Kinoshita & Co.*, 287 F. 2d 951, 953 (2d Cir. 1961). In that case, it was stated in dictum that such a clause "would clearly have been sufficiently broad to cover a dispute over fraudulent inducement. . . ." 287 F. 2d at p. 953.

In the leading case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2d Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), dismissed pursuant to Rule 60, 364 U. S. 801 (1960), the court held, in dealing with an arbitration clause similar to the one at bar, that: "We think that the charge of fraud in the inducement comes squarely within the phraseology of this particular agreement and that nothing short of a renascence of the old judicial hostility to arbitration could evolve a contrary ruling." 271 F. 2d at p. 412. See also p. 410 where Judge Medina, writing for the court, added that:

"Finally, any doubts as to the construction of the Act ought to be resolved in line with its liberal policy of promoting arbitration both to accord with the original intention of the parties and to help ease the current congestion of court calendars. Such "policy has been consistently reiterated by the federal courts and we think it deserves to be heartily endorsed. . . . Once it is settled that arbitration agreements are 'valid, irrevocable, and enforceable' we know of no principle of law that stands as an obstacle to a determination by the parties to the effect that arbitration should not be denied or postponed upon the mere cry of fraud in the inducement, as this would permit the frustration of the very purposes sought to be achieved by the agreement to arbitrate, i. e., a speedy and relatively inexpensive trial before commercial specialists."

Accordingly, the motion of the plaintiff to stay arbitration is denied and the motion of the defendant to stay this action pending arbitration is granted.

Settle order.

Dated: New York, N. Y.
February 10, 1966

/s/ THOMAS F. CROAKE
THOMAS F. CROAKE
U. S. D. J.

(Seal)

Appendix A—Opinions and Orders

Order of United States District Court for the Southern District of New York

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

65 Civ. 3416

ORDER

This cause having come on to be heard on the motion by plaintiff for an order, pursuant to Rule 65, Federal Rules of Civil Procedure, to stay arbitration, and on the motion by defendant, pursuant to Rule 7(b), Federal Rules of Civil Procedure and 9 U. S. C. A. §1 et seq., to stay this action pending arbitration, and the Court having heard the argument of counsel and being fully advised, it is

ORDERED that:

1. The motion by plaintiff to stay arbitration between the parties is denied.

2. The motion by defendant to stay this action until arbitration has been had in accordance with the terms of the Agreement between the parties dated October 7, 1964, is granted.

3. The parties are directed to proceed with arbitration in accordance with the terms of the Agreement between the parties dated October 7, 1964.

Dated: New York, New York
February 21st, 1966

/s/ THOMAS F. CROAKE
United States District Judge

U. S. District Court
Filed
Feb. 21, 1966
S. D. of N. Y.

Appendix A—Opinions and Orders

Opinion of United States Court of Appeals for the Second Circuit, Dismissing Appeal

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

September Term, 1965.

(Submitted March 30, 1966 Decided May 12, 1966.)

Docket No. 30365

[SAME TITLE]

Before:

WATERMAN, MOORE and FEINBERG,

Circuit Judges.

WATERMAN, *Circuit Judge*:

The district court ordered appellant and appellee to proceed with arbitration of their disputes and differences in accord with an agreement they had entered into providing for settlement by arbitration of "Any controversy or claim arising out of or relating to this Agreement, or the breach thereof."

Appellant timely filed a notice of appeal and appellee has moved to dismiss the appeal as frivolous. After a full examination of the moving papers, briefs and affidavits of the parties, and the memorandum opinion below, we grant the appellee's motion and dismiss the appeal.[1]

We but sketchily summarize the situation out of which the arbitrable disputes arose lest by too detailed a state-

[1] See *Chatham Shipping Co.* v. *Fertex S.S. Corp.*, 352 F. 2d 291, 294-95 (2 Cir. 1965).

ment we appear to be suggesting to the arbitrators the result they should reach.

On October 7, 1964, plaintiff-appellant, a Maryland corporation, and defendant-appellee, movant, a New Jersey corporation, entered into a contract which contained the following clause:

> 8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C.

On September 17, 1965, plaintiff notified defendant that plaintiff claimed defendant had breached the contract (and listed among the claimed breaches ten specific ones), and therefore plaintiff was going to pay to an escrow agent monthly payments it had agreed to pay defendant under the contract. On October 25, 1965, defendant notified plaintiff that it was demanding arbitration of plaintiff's failure to pay to it these agreed monthly payments. This notification was made pursuant to Section 7503(c) of the New York Civil Practice Law and Rules, and defendant filed a copy of its demand with the American Arbitration Association, with a request that the Association commence the pre-arbitration details. On November 12, 1965, defendant having agreed to grant plaintiff an extension of time until

November 15 within which to answer the arbitration demand, plaintiff commenced its action against defendant in the United States District Court for the Southern District of New York to obtain a rescission of the October 7, 1964 contract on the ground of alleged frauds by defendant at the time plaintiff was induced to enter into the contract. Plaintiff did not allege that it was fraudulently induced to enter into the arbitration clause.

Thereupon defendant moved pursuant to Rule 7(b), Fed. R. Civ. P. to stay plaintiff's action pending arbitration, and plaintiff cross-moved pursuant to Rule 65, Fed. R. Civ. P. to stay an arbitration pending adjudication upon the merits of plaintiff's action. Disposing of both motions simultaneously the district court denied plaintiff's motion, granted the stay defendant requested, and, as stated above, directed that an arbitration proceed.

Plaintiff's action is a diversity action, but if the contract sought to be rescinded evidences a transaction involving interstate commerce (excluding employment contracts of interstate workers) the arbitration clause in the contract is valid, irrevocable and enforceable unless grounds exist to revoke the contract, 9 U. S. C. §1, §2, and the court is required to order arbitration when "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue. . . ." 9 U. S. C. §4.

Beyond peradventure the contract evidences a transaction involving interstate commerce. It provides, among other things, that for a period of six years, New Jersey-based appellee would serve in an advisory and consultative capacity to Maryland-based appellant and would forthwith turn over to appellant two lists of appellee's paint customers, which lists included some 175 establishments lo-

cated in several states, which were active customers of appellee purchasing paint from appellee for resale. Among the matters concerning which appellee was to consult and advise appellant were, in appellant's words, "the manufacturing operations [and] sales and servicing of the customers accounts," and the agreement, according to appellant,

> "... contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers."

Appellant's complaint below, seeking rescission of the contract, is based upon allegations that appellee fraudulently induced appellant to enter into this contract knowing that appellee was insolvent and could not satisfactorily perform the contractual commitments.

It is appellant's claim that allegations of "fraud in the inducement" contained in a complaint seeking contract rescission halts arbitration until the validity has been determined of the contract of which the arbitration clause is a part because a rescission action seeks to nullify the existence of that contract. In this circuit, ever since the leading case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2 Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960) we have held that an arbitration agreement is separable from the contract within which it is contained. As it

is separable, we have held that when there is no allegation of fraud in the inducement to enter into the agreement to arbitrate any controversies or claims arising out of, or relating to, the agreement of which the arbitration agreement is a part, and which agreement is allegedly entered into by fraudulent inducement, the resolution of whether there was in fact fraud in the inducement is properly the province of the arbitrations and not of the court. *Robert Lawrence Company* v. *Devonshire Fabrics, Inc., supra* at 410; *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co.*, 289 F. 2d 346, 349 (2 Cir. 1961); *Petition of Kinoshita & Co.*, 287 F. 2d 951 (2 Cir. 1961); *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine Sales Corp.*, 274 F. 2d 805 (2 Cir.), *cert. denied*, 363 U. S. 843 (1960).

Here the arbitration provision incorporates the standard clause recommended by the American Arbitration Association, is broad and comprehensive, and, under the law of this circuit, would most assuredly cover a dispute over fraudulent inducement. See *Petition of Kinoshita & Co., supra.*

Appellant would distinguish *Robert Lawrence* v. *Devonshire* on the ground that there the party seeking the stay of arbitration had sued for damages for a contract breach while here appellant seeks a rescission. We recognize the distinction, but point out that, though the recovery sought in the two cases may differ, the ground upon which each recovery is sought is that of the alleged fraudulent inducement, an issue we hold is one for the arbitrators to resolve. See also *Fabrex Corp.* v. *Winard Sales Co.*, Sup. Ct. New York County, 200 N. Y. S. 2d 278 (1960).

Appellant also maintains that, inasmuch as appellee served a notice to arbitrate pursuant to a provision of New York law prior to appellant's institution of suit in a federal court, appellee's federal court motion to compel arbitration filed in the federal court appellant chose, does not cause federal law to govern as to whether the issue of alleged fraud in the inducement should be adjudicated in court or resolved by arbitrators, but that New York law should control.

There is no merit in this contention. We quote *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., supra* at 409, and

> "... hold that the Arbitration Act in making agreements to arbitrate 'valid, irrevocable, and enforceable' created national substantive law clearly constitutional under the maritime and commerce powers of the Congress and that the rights thus created are to be adjudicated by the federal courts whenever such courts have subject matter jurisdiction, *including diversity cases,* just as the federal courts adjudicate controversies affecting other substantive rights when subject matter jurisdiction over the litigation exists. We hold that the body of law thus created is substantive not procedural in character and that it encompasses questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements affecting interstate commerce or maritime affairs, since these two types of legal questions are inextricably intertwined." (Emphasis supplied.)

El Hoss Engineer. & Transport Co. v. *American Ind. Oil Co., supra; Petition of Kinoshita & Co., supra; Metro Industrial Painting Corp.* v. *Terminal Const. Co.*, 287 F. 2d 382 (2 Cir. 1961) at 384-385, and see separate concurring opinion of Judge Lumbard at 385 ff.; *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine Sales Corp., supra.*

Appellee has moved for a grant to it of double costs, damages, counsel fees and expense reimbursement, all pursuant to 28 U. S. C. §1912, citing *Chatham Shipping Co.* v. *Fertex S.S. Corp.*, 352 F. 2d 291, 294-95 (2 Cir. 1965), and *A/S Krediit Pank* v. *Chase Manhattan Bank*, 303 F. 2d 648 (2 Cir. 1962). Appellee's motion is not wholly ill-founded, but we believe it better to deny it, for arbitration should now proceed promptly.

Appeal dismissed.

Appendix A—Opinions and Orders

Order of United States Court of Appeals for the Second Circuit, Dismissing Appeal

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twelfth day of May, one thousand nine hundred and sixty-six.

Present:

HON. STERRY R. WATERMAN,
HON. LEONARD P. MOORE,
HON. WILFRED FEINBERG,
Circuit Judges.

[SAME TITLE]

A motion having been made herein by counsel for the appellee to dismiss the appeal for frivolousness and for other and further relief,

Upon consideration thereof, it is

Ordered that said motion be and it hereby is granted and that the appeal from the United States District Court for the Southern District of New York be and it hereby is dismissed with costs to the appellee.

A. DANIEL FUSARO
Clerk

Appendix B—Text of Statutes Involved

Statutes

FEDERAL ARBITRATION ACT

"§2. *Validity, irrevocability, and enforcement of agreements to arbitrate.*

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

"§3. *Stay of proceedings where issue therein referable to arbitration.*

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

"§4. *Failure to arbitrate under agreement; petition to United States Court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination.*

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any Court of the United States which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties for an order directing that such arbitration proceed in the manner provided for in such agreement . . . The Court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply herewith is not in issue, the Court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the Court shall proceed summarily to the trial thereof . . . When such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue . . ."

New York Civil Practice Law and Rules

"7503. *Application to compel or stay arbitration; stay of action; notice of intention to arbitrate.*

(c) Notice of intention to arbitrate. A party may serve upon another party a notice of intention to arbitrate, spe-

cifying the agreement pursuant to which arbitration is sought and the name and address of the party serving the notice, or of an officer or agent thereof if such party is an association or corporation, and stating that unless the party served applies to stay the arbitration within ten days after such service he shall thereafter be precluded from objecting that a valid agreement was not made or has not been complied with and from asserting in court the bar of a limitation of time. Such notice shall be served in the same manner as a summons or by registered or certified mail, return receipt requested. An application to stay arbitration must be made by the party served within ten days after service upon him of the notice or he shall be so precluded. Notice of such application shall be served in the same manner as a summons or by registered or certified mail, return receipt requested.

Appendix C—Exhibits

Complaint

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

Plaintiff Demands Trial by Jury

Plaintiff, complaining of the defendant, by its attorney, ROBERT P. HERZOG, respectfully shows and alleges:

FIRST: Jurisdiction is founded on a diversity of citizenship and amount. Plaintiff is a corporation incorporated under the laws of the State of Maryland, having its place of business in the State of Maryland, and the defendant is a corporation incorporated under the laws of the State of New Jersey, having its principal place of business in a state other than the State of Maryland. The matter in controversy exceeds, exclusive of interest and costs, the sum of $10,000.00.

SECOND: That on October 7, 1964, plaintiff, Prima Paint Corporation (hereinafter referred to as "Prima"), and defendant, Flood & Conklin Mfg., Co. (hereinafter referred to as "F & C"), executed an agreement in writing, which was contemporaneously supplemented and adjusted, wherein and whereby, *inter alia*, Prima employed F & C and F & C agreed to work for Prima for a six year period. A copy of the said agreement, without its contemporaneous supplements and adjustments, is hereto annexed as Exhibit A and made a part hereof, as if fully set forth at length.

THIRD: That by the terms of the aforesaid agreement, F & C promised to serve Prima in an advisory and consultative capacity to the extent that Prima may reasonably require, in connection with the formulae, manufacturing operations, sales and servicing of Prima's trade sales accounts.

FOURTH: That in consideration of the foregoing promise of F & C, Prima agreed to pay to F & C a percentage of all its receipts from customers of F & C or customers who purchased F & C's products, as defined in the said agreement, for the next six years, the total aggregate to F & C, however, not to exceed $225,000.00.

FIFTH: Among the provisions of the said agreement, it was provided that any controversy or claim arising therefrom would be settled by arbitration in the City of New York.

SIXTH: That upon the urging of F & C, its agents, servants, employees or attorneys, Prima was fraudulently induced to accelerate the execution and closing date of the said agreement herein, from October 21, 1964 to October 7, 1964.

SEVENTH: That prior to the execution of the aforesaid agreement, F & C, its agents, servants, employees, or attorneys, represented and stated to Prima that F & C was in all respects a solvent corporation and able to perform all of the terms and conditions of the said agreement on its part to be performed.

EIGHTH: That the said representations and statements made by F & C, its servants, agents, employees or attorneys, that it was in all respects a solvent corporation and able to perform all the terms and conditions of the agreement on its part to be performed, were false and fraudulent when made and that F & C, its agents, servants, employees, or attorneys, knew or had reasonable cause to know that the representations and statements were false and fraudulent when made.

NINTH: That in truth and in fact, F & C was an insolvent corporation, and its agents, servants, employees or attorneys knew or had reasonable cause to know same, and upon information and belief, had consulted attorneys with regard to or had participated and prepared applications for a proceeding pursuant to the insolvency provisions of Chapter XI of the Bankruptcy Act.

TENTH: That on or about October 14, 1964, F & C filed a voluntary petition under the provisions of Chapter XI, Section 322 of the Bankruptcy Act in the United States District Court for the District of New Jersey.

ELEVENTH: That Prima, not knowing the truth with regard to the said statements and representations, but believing them to be true, and in reliance thereon, was thereby induced to accelerate the closing date thereof and execute the agreement referred to herein as Exhibit A.

TWELFTH: That Prima relied on the aforesaid false and fraudulent representations and statements that F & C

was in all respects a solvent corporation and able to perform all the terms and conditions of the agreement on its part to be performed, and Prima would not have accelerated the date of the execution, nor would Prima have entered into the said agreement hereinabove set forth, but for the false and fraudulent representations and statements made by F & C.

THIRTEENTH: That plaintiff has no adequate remedy at law.

WHEREFORE, plaintiff demands judgment that the agreement herein dated October 7, 1964, be rescinded, declared null and void, that Prima and F & C be made whole, and that the plaintiff have such other, further and different relief as to the Court may seem just and proper, together with the costs and disbursements of this action.

ROBERT P. HERZOG
Attorney for Plaintiff
Office & P. O. Address
280 Madison Avenue
New York, New York, 10016

PLEASE TAKE NOTICE, that pursuant to the provisions of the Rules of Civil Procedure, Prima Paint Corporation, plaintiff herein, demands a trial by jury of the issues raised herein.

Appendix C—Exhibits

Consulting Agreement

CONSULTING AGREEMENT dated October 7, 1964, between PRIMA PAINT CORPORATION, a Maryland corporation ("Prima"), and FLOOD & CONKLIN MFG. Co., a New Jersey corporation ("F&C").

Prima desires to secure the services of F&C on an advising and consulting basis, in connection with the takeover and operation of the Trade Sales business formerly conducted by F&C, and F&C is willing to perform such services.

NOW, THEREFORE, in consideration of the premises and of the mutual agreements hereinafter set forth, the parties hereto agree as follows:

1. *Employment and Term.* Prima hereby employs F&C and F&C agrees to work for Prima, on the terms and conditions hereinafter set forth, for a six year period (hereinafter called the "Consulting Period") commencing at the date hereof and ending at the close of business on October 7, 1970.

2. *Services.* During the Consulting Period, F&C shall serve Prima in an advisory and consultative capacity to the extent Prima may reasonably require, in connection with the formulae, manufacturing operations, sales and servicing of Prima Trade Sales accounts. It is agreed that such services shall be performed by Jerome K. Jelin,

Chairman of F&C except in the event of his death or disability, and F&C agrees to employ him for such purpose. Any out of pocket expenses incurred at Prima's request shall be reimbursed to F&C.

3. *Covenant Not to Compete.* F&C agrees that for a period of seventy-two (72) months from and after the date hereof it will not make any Trade Sales of paint or paint products (a) in the territory in which it was making such trade sales within the year prior to this date, or (b) to any of the customers who purchased Trade Sales paint or paint products from F&C within the said one year period prior to this date.

4. In consideration of F&C's agreement not to compete in trade sales of paint and paint products and in consideration further of F&C's agreement to act as a consultant to Prima, Prima agrees to make payments to F&C in the amount and under the terms and conditions as follows (it being understood and agreed that wherever reference is made to "Prima" herein it shall include Prima as well as all of its subsidiaries and/or affiliates engaged in the paint business):

(a) Prima agrees to pay F&C an amount equal to Five (5%) percent of all of its receipts from customers of F&C listed in Exhibit "A" hereto, and Two (2%) percent of its receipts from those listed in Exhibit "B" hereto, in either case arising out of the sale of any and all paint and/or paint products by Prima to those so listed in Exhibits "A" and "B" during the term hereof, whether

the paint and/or paint products so sold bears the labels, trade names heretofore used by F&C or any other labels, trade names or designation.

(b) Prima agrees during the term hereof to pay F&C an amount equal to Five (5%) percent of all of its receipts from its customers other than those covered by subdivision (a) who purchase F&C products (as hereinbelow defined), and except that where such customers are supermarkets other than those listed in Exhibit "B" hereto, Prima shall only pay to F&C Two (2%) percent of its receipts from said supermarket customers. As used herein, F&C products shall mean any and all paint and/or paint products sold under the trade names, brand names, trade marks, formulae, patents and/or labels sold to Prima pursuant to Agreement with F&C dated August 21, 1964.

(c) Starting the first day of the eleventh month after the closing date, namely, September 1, 1965, and on the first day of every month thereafter during the term hereof, Prima shall pay the sum of $2,500.00 per month to F&C as an advance against the percentage payments described in subparagraphs "(a)" and "(b)" of this Paragraph "4". If, however, the sales volume encompassed by subparagraphs "(a)" and "(b)" accounts shall fall below $600,000. in any full calendar year beginning with the year 1965, then Prima's obligation under this subparagraph "(c)" shall in the immediately succeeding year be reduced by $500. per month for each $100,000., or fraction thereof, of sales by which the aggregate sales falls below $600,000. If the sales in any later years increase and exceed $600,000.

then the original amount to be paid monthly shall be resumed. By way of illustration: if such sales in the calendar years 1966, 1967 and 1968 should aggregate $450,000., $750,000. and $525,000., respectively, then the monthly advances to be paid in the years 1967, 1968 and 1968 shall be $1,500.00, $2,500.00, and $2,000.00 respectively.

(d) Beginning on the fifteenth day of February, 1965 and on the fifteenth day of every third month thereafter, Prima shall render to F&C a statement verified by Prima's chief financial officer, which statement shall (i) set forth the status of the account between the parties pursuant to "(a)" and "(b)" above, and (ii) itemize all sales made, and all payments received, by Prima, by customer name and amounts during the preceding three (3) months. The initial statement rendered hereunder shall cover the entire period from the closing date to the end of December, 1964.

(e) On March 1, 1965 and every March 1st thereafter, and then finally on the first day of the 74th month after the closing date, Prima shall render to F&C a statement certified by a certified public accountant setting forth the status of account between the parties covering the preceding calendar year (the statement rendered on the 74th month shall cover only the period beginning with the last preceding January 1st until the end of the term hereof). At the time each statement required to be made under this subparagraph "(e)" is rendered, there shall be a cash settlement of the account between the parties.

(f) For the purposes of computing the amounts required to be paid under subparagraphs "(a)" and "(b)"

hereunder, the amount of Prima's receipts shall be deemed to be the amount actually received plus any amounts by which the basic sales price has been reduced because of credits, allowances or waivers which relate directly or indirectly to allowances for advertising.

(g) The payments by Prima under "(a)" and "(b)" hereof shall cease when the aggregate amount paid to F&C equals $225,000. or upon the expiration of the term hereof, whichever is the first to occur.

(h) Notwithstanding the expiration of the term hereof, Prima shall continue to make payments to F&C based on the percentages set forth in subparagraphs "(a)" and "(b)" for all payments received by Prima after the expiration date arising out of sales encompassed by said subparagraphs which were shipped before the expiration date. On the tenth of the second month following the expiration date, and on the tenth of each month thereafter, Prima shall account and make payments to F&C under this subparagraph "(h)" covering all applicable receipts of the preceding months or month, as the case may be.

(i) Prima shall maintain for a period of seven (7) years from the date hereof all necessary books and records to substantiate the sales and receipts reports provided for herein. F&C shall have the right and authority to audit or otherwise verify Prima's sales and receipts and to that end shall have access to all relevant records of Prima.

5. *Notices.* Any notice to be given to F&C hereunder shall be sent by registered or certified mail addressed to it at 136 Chestnut Street, Newark 5, New Jersey, and c/o Wachtel & Michaelson, 575 Madison Avenue, New York, New York 10022, and any notice to be given to Prima hereunder shall be sent by registered or certified mail addressed to it at 819 South Caroline Street, Baltimore, Maryland, and c/o Charles M. Cahn, Jr., 912 Fidelity Building, Baltimore, Maryland.

6. *Miscellaneous.* (a) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(b) This Agreement embodies the entire understanding of the parties on the subject matter and no amendment or modification of it shall be valid or binding upon the parties unless in writing.

7. Notwithstanding anything to the contrary contained herein, if at any time prior to the full completion of the payments due F&C from Prima, as set forth in paragraph "4" hereof, (i) there shall be filed against Prima in any court, pursuant to any Federal or state statute, a petition in bankruptcy or insolvency or for reorganization or for the appointment of a receiver or trustee of all or substantially all of Prima's property, and such petition shall not be stayed, dismissed or vacated within forty-five (45) days after the filing thereof, or (ii) Prima shall itself file as aforesaid a petition in bankruptcy or insolvency or for reorganization under any Federal or state statute in aid

of debtor or for the appointment of a receiver or trustee of all or a substantial part of its property, or (iii) Prima shall make an assignment for the benefit of creditors, or (iv) the estate or interest of Prima in the trade names and labels and/or the customer accounts and/or the good will represented thereby, shall be levied upon or attached in any proceeding and such process is not vacated or discharged or adequately bonded by Prima within twenty (20) days after such levy or attachment, or (v) Prima fails to make any payments due to F&C as provided for in Paragraph "4" and within thirty (30) days after notice that such payments are delinquent, fails to make such payment or fails to adequately bond such amount or pay such amount in escrow to Messrs. Harry H. Wachtel and Charles M. Cahn, Jr., jointly, then and in any of such events there shall immediately become due to F&C from Prima the sum of $225,000., less any payments made pursuant to Paragraph "4", and in addition, all rights, estate or interest of Prima in and to the customer accounts set forth in Exhibits "A" and "B" annexed hereto, the trade names and labels and formulae comprising the F&C products shall automatically revert at once to F&C and shall once again become the absolute property of F&C without liability of any kind whatsoever on F&C's part to return or repay any portion of the payments received by F&C from Prima hereunder. In any such event, no person, firm, corporation or other entity, except F&C shall have or obtain the aforesaid rights, estate or interest in and to said customer accounts, trade names and labels, and formulae or in and to the right to use said names or labels for the purpose set forth above.

8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C.

9. *Miscellaneous.* (a) Prima agrees that it will not sell, transfer or dispose of any of the customer accounts set forth in Exhibits "A" and "B" annexed hereto, or the trade names and labels and formulae comprising the F&C products to any person, firm, or company unless such person, firm or company expressly undertakes to assume the obligation of Prima hereunder. In the event of any violation of this Agreement, then the provision of paragraph 7 shall apply.

(b) The individuals, partnerships or corporations listed in Exhibits "A" and "B", shall for all purposes hereof be deemed to include any successor entity thereto whether the same arises from merger, consolidation, combination or otherwise.

(c) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(d) This Agreement embodies the entire understanding of the parties on the subject matter and no amendment or modification of it shall be valid or binding upon the parties unless in writing.

IN WITNESS WHEREOF, the parties hereto have caused this Purchase Agreement to be duly executed on the day and year first above written.

FLOOD & CONKLIN MFG. CO.

By: /s/ JEROME K. JELIN
Jerome K. Jelin, Chairman

ATTEST:

/s/ ARTHUR M. GOLDEN
Arthur M. Golden, President

PRIMA PAINT CORPORATION

By: /s/ (Illegible)

ATTEST:

/s/ (Illegible)

Appendix C—Exhibits

Demand for Arbitration

October 25, 1965

Prima Paint Corporation
819 So. Caroline Street
Baltimore, Maryland

Prima Paint Corporation
c/o Charles M. Cahn, Jr.
912 Fidelity Building
Baltimore, Maryland

PLEASE TAKE NOTICE, under Section 7503, Subdivision (c) of the Civil Practice Law and Rules of the State of New York, that the undersigned, pursuant to the provisions of a contract dated October 7, 1964, which agreement provides as follows:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C."

hereby demands arbitration thereunder.

NATURE OF DISPUTE:

Failure by Prima Paint Corporation to make payments to Flood & Conklin Mfg. Co. in the sum of $2,500 on the first day of each month, commencing September 1, 1965,

pursuant to the terms of a written contract between the parties dated October 7, 1964.

CLAIM OR RELIEF SOUGHT:

An award that Prima Paint Corporation is liable to Flood & Conklin Mfg. Co. for payments of $2,500 per month commencing as of September 1, 1965, and continuing thereafter as set forth in the aforesaid contract between the parties dated October 7, 1964.

PLEASE TAKE FURTHER NOTICE, that unless within ten days after service of this Notice of Intention to Arbitrate, you apply to stay the arbitration herein, you shall thereafter be precluded from objecting that a valid agreement was not made or has not been complied with and from asserting in court the bar of a limitation of time.

HEARING LOCALE REQUESTED:

New York City (Pursuant to the terms of the Agreement).

You are hereby notified that copies of our Arbitration Agreement and of this Demand are being filed with the American Arbitration Association in its New York Regional Office, with the request that it commence the administration of the arbitration.

Yours, etc.

WACHTEL & MICHAELSON
Attorneys for Flood & Conklin Mfg. Co.
Office & P. O. Address
575 Madison Avenue
New York, NY 10022

Appendix D

Excerpts From Petition for Writ of Certiorari in *Lawrence* v. *Devonshire*

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REASONS FOR GRANTING THE WRIT

1. The Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.*

The court below not only decided (a) that both the validity and the interpretation of arbitration clauses in interstate contracts were governed by a newly evolved concept of federal substantive law of arbitration, but, also, (b) recognized that this conclusion required that all state courts—though operating under their own arbitration laws and laws of contract—must henceforth adjudicate questions of the validity and interpretation of arbitration clauses in all interstate contracts in accordance with Federal law and Federal decisions. Said the court below (271 F. 2d at 407; pp. A 24--25):

> "... Congress based the Arbitration Act in part on its undisputed substantive powers over commerce and maritime matters ... Section 2 declaring that

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* The court below said (271 F. 2d at 404; p. A 19):

> "The case involves questions left open by the Supreme Court in Bernhardt v. Polygraphic Co. of America, Inc., 1956, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199, and these questions are interesting and important. The basic inquiry must be whether the validity and interpretation of the arbitration clause of the contract in this case is governed by Federal law, i.e., the Federal Arbitration Act, or by local law."

> arbitration agreements affecting commerce or maritime affairs are 'valid, irrevocable, and enforceable' . . . must mean that arbitration agreements of this character, previously held by state law to be invalid, irrevocable or unenforceable are now made 'valid, irrevocable and enforceable.' This is a declaration of national law equally applicable in state or federal courts."

The importance of the decision is obvious.* The decision is important not only to the textile industry out of which the present case arises and in which arbitration clauses are all but universal,** but also because it both cuts across the whole field of arbitration law and propounds a novel principle that can drastically affect and create confusion as to the powers of federal and state courts.

The court below in deciding the "interesting and important" questions it considered that this Court had left open in *Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198 (1956), reached a conclusion contrary to

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* The New York Times of the day following the decision, October 29, 1959, carried a front page story to the effect that the decision "was believed to represent a revolutionary concept in interpreting the intention of Congress in enacting the Federal Arbitration Act." The decision was reported in New York City radio news broadcasts on the evening of the decision and on the morning following.

** The American Arbitration Association records show that 652 commercial arbitrations were conducted by it alone in 1957; 525 private civil contract cases based on diversity of citizenship were instituted in the six United States District Courts for the Second Circuit in the fiscal year ending June 30, 1959.

the central principle that this Court regarded as dispositive of that case (p. 203):

> "If the Federal court allows arbitration where the state court would disallow it, the outcome of litigation might depend on the courthouse where a suit is brought."

For the court below acknowledged (271 F. 2d at 412, p. A 34):

> "We note that were we compelled to apply New York law to the problems involved in this case we would have been forced to arrive at a contrary conclusion."

On the one hand this Court in the *Bernhardt* case treated the question as a part of the law of remedies which law, because it could affect the outcome of the litigation, would have to be determined in accordance with the law of the state in which the litigation was pending, including the Conflict of Laws rules of that state. On the other hand the court below has squarely held that the Federal Arbitration Act is substantive in its application to interstate contracts and therefore preempts the interpretation of all arbitration clauses (but only such clauses) in contracts involving interstate commerce. The court below, indeed, explicitly disagreed with the view of Mr. Justice Frankfurter, expressed in his concurring opinion in the *Bernhardt* case, that the Federal Arbitration Act should be held wholly inapplicable in diversity cases.

The decision below thus has invented a novel and unworkable principle under which two laws would separately apply to different parts of the same contract. State law, though generally the source of contract rights, would be

substantively displaced as to part of the contract. More than that, state courts would have to substitute for their own law as to such part, a fresh body of federal contract precedents to be gleaned from Courts in 86 Federal Districts in 50 states, Courts of Appeals in eleven circuits and, ultimately, from necessarily infrequent clarifying decisions in this Court.

Thus, the decision below importantly concerns the definition of state-created rights as against federally-created rights, the essential nature of the Federal Arbitration Act in its relation to commercial contracts involving interstate commerce as remedial or substantive law, and the scope and application of the principles that this Court was thought to have settled in the *Bernhardt* case.

2. The Court of Appeals has rendered a decision directly in conflict with the decisions of the Court of Appeals for the Sixth Circuit in *American Airlines, Inc.* v. *Louisville and Jefferson County Air Board*, 269 F. 2d 811 (1959) and the Ninth Circuit in *Ross* v. *Twentieth Century-Fox Film Corporation*, 236 F. 2d 623 (1956).

The Circuit Court of Appeals for the Sixth Circuit in the *American Airlines* case held, a month before the decision below was rendered, that in determining whether an arbitration clause contained in a lease of airport facilities was valid, the District Court had been right in applying local state law rather than federal law, notwithstanding that the transaction involved commerce among the states.*

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* Apparently the Second Circuit Court of Appeals did not have the advantage of considering the opinion in the *American Airlines* case as it is not cited.

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The decision in the case at bar is in acknowledged conflict with the decision of the Ninth Circuit Court of Appeals in *Ross* v. *Twentieth Century-Fox Film Corporation*, 236 F. 2d 632 (1956). The court there held that "even if this [interstate] contract is of the sort contemplated by Section 3 of Title 9, the interpretation of the contract is still a matter of California law, and it must be determined by reference to that law whether the contract contains language which amounts to a provision for arbitration." The court in the case at bar put the *Ross* case aside as being founded on an erroneous reading of this Court's decision in the *Bernhardt* case (271 F. 2d at 409; p. A 27).

3. The decision of the court below has overturned a long-standing construction of Federal law and reached a conclusion at variance with earlier decisions in the Second and other circuits in its conception of a new principle of law applicable to the enforceability of arbitration clauses.

For the first time in 34 years the Federal Arbitration Act has been interpreted so as to compel arbitration of a contract obtained through fraud.

The Court in the case at bar has in effect overturned the earlier decision of the Second Circuit in *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.*, 126 F. 2d 978 (2d Cir. 1942), a case involving denial of the making of a charter party containing an arbitration clause. The earlier court held (a) that arbitrators could not—without impermissible self-stultification—pass upon the question whether the contract to which they owed their appointment had validly come into existence, and (b) that the

Federal Arbitration Act clearly did not contemplate arbitration of a controversy over the existence of the contract embodying the arbitration agreement (126 F. 2d at 986).

The court below brushed this decision aside as dealing with a case in which one party altogether denied that any contract had been made (271 F. 2d at 411, p. A 33) but that "distinction" equally comprehends any case like the present one, of fraud in the inducement of an entire transaction.

The court below openly disagreed with and put to one side as unconsidered the decision of the Sixth Circuit Court of Appeals in *Kentucky River Mills* v. *Jackson*, 206 F. 2d 111 (1953) which treated the issue of fraud in inducing a contract as an issue that had to be judicially litigated and one which could not be made the subject of arbitration (271 F. 2d at 411, p. A 33).

The court in the case at bar is also in apparent disagreement with other cases, which have assumed that the Federal Arbitration Act does not require arbitration where the contract containing the alleged agreement to arbitrate has itself been induced by a fraud. *Reynolds Jamaica Mines, Ltd.* v. *La Societe Navale Caenaise*, 239 F. 2d 689 (4th Cir. 1956); *Almacenes Fernandez, S.A.* v. *Godoletz*, 148 F. 2d 625, 628 (2d Cir. 1945); *McElwee-Courbis Construction Co.* v. *Rife*, 133 F. Supp. 790, 794 (M. D. Pa. 1955).

It is plain therefore that the decision of the court below on the arbitrability of fraud in the inducement is contrary to the gist and trend of the decisions in other circuits, including earlier decisions in the court below and overturns a substantial body of cases.

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4. The court below manifestly misinterpreted Section 2 of the Federal Arbitration Act in developing its novel doctrine that an arbitration clause contained in a contract is "separable" from the contract of which it is a part.

This novel doctrine is directly in conflict with *Kulukundis* which held 126 F. 2d 985-6 that an arbitration clause is an integral part of the contract.

In so disagreeing, the court found that it is not enough that there be substance to petitioner's "charge that the contract to deliver merchandise of a certain quality was induced by fraud" but that petitioner—beyond that—had to show that it had been induced—specifically—to sign the arbitration clause itself by a fraud directed to that clause.

The Circuit Court concluded, as a matter of law on the facts before it, that petitioner had not been induced by any particular fraud directed to arbitration matters to assent to the inclusion of that clause in the contract. The court concluded—therefore—that petitioner could not be relieved of the obligation to arbitrate.

If it were correct, the decision would be of far-reaching importance. The court below was consciously rejecting the argument that if "the entire transaction was induced by fraud . . . the arbitration provision necessarily falls with the rest" (271 F. 2d at 411, p. A 32). But assent to a contract is not partible, nor is is distributable to clauses of a contract, when the reality is that no part of the contract would have been entered into at all had the fraud gone uncommitted. The court below sought to translate the structure of the Federal Arbitration Act into a far-reaching principle—that fraud warrants only the rescission of

those parts of a contract to which the misrepresentations specifically relate and does not to any other extent negate the reality of the contract as a whole.

The novel principle proposed is as false in reason as it is in its realism. The fraud practised to induce a transaction permeates it. It takes less than an instant of reflection to realize that men do not consciously and separably agree to arbitrate the possibility that the entire transaction in which they are engaging has been the product of a fraud upon them. Realistically their assent to arbitration is confined by the assumption that the transaction is founded in candid commercial dealing and will operate within the limits of contractual obligations genuinely arrived at.

In the market place the arbitration clause of a contract is never considered separately by business men much less signed separately. In almost every textile case it is a "small print" clause on the reverse side of the order. To suppose that there could ever be a fraud as to such a clause alone separate and apart from the entire contract is to ignore the true realities of the business world.

It is imperative therefore that the important question of federal law arising from the novel approach of the Circuit Court in the case at bar and overturning long standing precedent be resolved by this court.

* * *